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MANUFACTURERS HANOVER

Financial Digest

Volume XXVII, Number 5 Monday, February 26, 1990

Analysis of Business Trends Plus Selected Financial Indicators

Monetary Policy Constraints

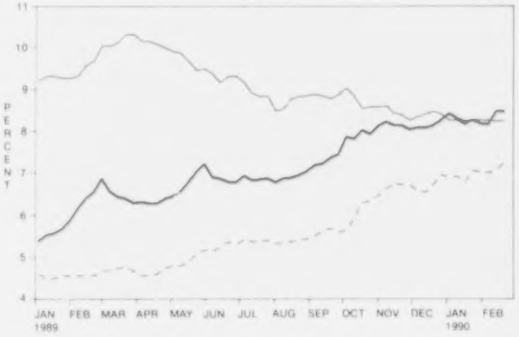
Sharp price reversals and escalating yields in the world's major bond markets are now underscoring not only the growing integration of the global financial markets, but also new constraints on the Federal Reserve's conduct of monetary policy. For although the overwhelming weight of evidence points to a marked slowdown in the pace of business in this country, and by some yardsticks in the rate of inflation, too, long-term interest rates are behaving as if the opposite were true. Meanwhile, the Fed is exhibiting a marked reluctance to further ease its grip on the monetary reins.

Although this hesitancy is usually attributed to Fed Chairman Alan Greenspan's view that recession risks have waned, there is something else as well. This is the increasing influence of foreign capital in the U.S. financial markets. With foreign interest rates trending higher, there is a possibility that a unilateral move by the Fed to lower interest rates in order to stimulate the U.S. economy may well backfire, triggering a large outflow of interest-sensitive capital, a decline in the foreign exchange value of the dollar and an acceleration of imported inflation. Although there is little proof that this would happen, no one wants to find out. Bond rates have already been dragged higher by rising overseas rates; short-term rates have begun to follow while the need for ease remains.

As shown in the chart, while the slide in Eurodollar deposit rates has come to an abrupt halt, German and Japanese interest rates continue to spiral higher. In Germany, the rate rise stems from inflation fears fanned by the staggering financial implications of the reunification of West and East Germany while in Japan, the same price fears have been ignited by the combination of an anemic yen and brisk economic growth. Regardless of the reasons, the fact is that most German interest rates now exceed comparable U.S. rates for the first time in nearly ten years, and the differential between U.S. and Japanese interest rates has narrowed to its smallest point in 3½ years.

With the United States relying increasingly on foreign capital to finance a slice of everything from commercial construction to auto assembly plants to a third of new Treasury debt offerings, the recent turn of global interest rates carries with it high stakes. Internationally competitive yields are no longer a luxury for this country, but a necessity for smoothly functioning credit markets. And, herein lies the rub. As evidence

3-MONTH DEPOSIT RATES: EURODOLLAR (THIN) VS. EURODM (THICK) VS. EUROYEN (DASH) (WEEKLY AVERAGES)



Source: MH

mounts that the backup in bond yields is feeding back into the money markets, raising speculation that the banks' prime lending rate is coming under pressure, today's inertia amounts to a tacit admission of a partial loss of monetary policy sovereignty, since there is little on the domestic side of the ledger to preclude an easing by the Fed.

Recession Risks Receding?

For one thing, the economy is still moving sideways at best, with the industrial sector downright weak. Although cutbacks in the automobile industry are at the center of industry's lethargy, the toll extends well beyond Detroit. Manufacturing hasn't added one new job in nearly a year, industrial output is no higher today than last spring and factory operating rates are still headed south. What is more, near-term investment spending will be pinched by declines in "real" cash flow. Add to this the rising proportion of exporters reporting a slowdown of new orders, the ongoing drop in the actual number of new homes being sold, the erosion of consumer confidence and the rise in unemployment insurance claims and it becomes somewhat more understandable why even Fed Chairman Greenspan is hedging his bets. In last week's testimony before the Congress, Mr. Greenspan in effect stated that the modest firming of economic activity that the Fed thinks

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is underway may well be just a clearing in the recessionary woods.

For another, the inflation outlook doesn't place any undue obstacles in the path of additional ease. Although the Fed finds itself uncomfortable with a 4½ percent inflation rate, the fact is that "core" inflation at the producer level, is still slowing and, at the consumer level it isn't all that much different from recent years. Producer prices, excluding food and energy, are now advancing at a less than four percent year-over-year clip, their slowest rate of rise since mid-1988. Consumer prices, excluding food and energy, are up 4.4 percent over the past 12 months, not far from the preceding five-year annual average of 4.2 percent. This suggests two things. First, the peak of producer price inflation may have passed and, second, "core" rates of consumer price inflation have not changed much in recent years, and probably won't in the near term.

Commercial Banks On The Sidelines

But even if the Fed could sidestep today's international constraints and did ease, it might not do much good. Lenders are becoming increasingly reluctant to lend money, and for

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (2/7/90)	217,336	+ 1,308	+ 9,330
New York City (2/14/90)	41,422	+ 208	- 483
Commercial Paper (2/14/90)	534,680	+ 688	+ 53,263

Bank Loans

(Millions of Dollars)

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Commercial and Industrial Loa			
Nationwide (2/7/90)	321,160	+ 1,206	+ 11,49
New York City (2/14/90)	59,313	+ 320	+ 1,40
Total Loans and Leases Gross Adj			
Nationwide (2/7/90)	1,000,738	- 2,685	+ 60,99
New York City (2/14/90)	184,785	+ 4,169	+ 5,25

Financial Markets

	Friday 2/23/90	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	7.92%	–0–	- 1.04
180-Day Bills†	8.07	+ .01	- 1.15
Longest Bills†	8.09	+ .01	- 1.40
Recent Issues:			
8⅛s 2/28/92 (When Issued)	8.41	NA	
7⅞s 12/31/93	8.49	+ .12	
8⅛s 12/15/00	8.53	+ .12	
8⅛s 2/15/20	8.56	+ .10	
Municipals:			
Bond Buyer—20 Bond Index* (2/22/90)	7.27%	+ .11	- .28
Blue List Total ($ Million)	$1,380	+ $172	+ $102
30-Day Visible Supply ($ Million)	$1,788	+ $518	- $ 58
Total	$3,168	+ $690	+ $ 44
Corporates:			
Moody's Aa Composite (2/22/90)	9.48	+ .05	- .44
30-Day Visible Supply ($ Million)	$1,350	- $200	- $533
Stocks:			
Dow-Jones Averages:			
Industrials	2,564.19	- 71.40	+318.65
Transportation	1,081.26	+ 1.96	+ 9.30
Utilities	216.86	- 4.41	+ 35.02
65 Stocks	958.35	- 17.23	+ 94.02
N.Y.S.E. Composite Index	179.35	- 4.40	+ 15.26
N.Y.S.E. Avg. Daily Vol. for Week (000's)	160,378	+ 11,532	+ 5,993

*34% Taxable equivalent 11.10%. † Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 2/9/90	Week Ago
Overnight	8.19%	8.13
1 month	8.19	8.19
3 month	8.25	8.25
6 month	8.31	8.25
1 year	8.56	8.50

FOREIGN EXCHANGE SPOT RATES New York Opening (2/9/90)	Currency Per U.S. $	Week Ago
Belgium	34.95	35.39
Canada	1.2017	1.2009
France	5.6850	5.7550
Germany	1.6760	1.6780
Italy	1239.00	1255.55
Japan	147.00	144.65
Mexico	2703.00	2696.00
Netherlands	1.8905	1.9085
South Korea	691.60	690.10
Switzerland	1.4737	1.4925
Taiwan	26.15	26.12
U.K.*	1.7085	1.6890

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (2/23/90) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27
	+0.4%	-2.6

good reason. By exhorting commercial banks to curtail lending in order to shrink their balance sheets and shore up capital ratios, the regulators and stock analysts have supplanted usury ceilings as inhibitors of bank credit growth. This is raising again the specter of the kind of credit crunch that occurred in the 1960s and 1970s, when there were limits on how much banks could pay for deposits and charge for loans. Real estate developers currently find themselves at the cutting edge of this liquidity squeeze, but it also extends to borrowers contemplating highly-leveraged transactions as well as to small- and medium-sized borrowers.

Foreign factors and lender caution are working in tandem to box in Fed flexibility. While not much can be done about the latter, there is one way to remove the international shackles. Washington could trim its budget deficit and reduce our dependence on foreign capital. But, with interest rates again rising and large chunks of the economy already weak, a hefty dose of fiscal restraint now might be enough to tip the economy into the very recession that everyone wants to avoid. Under these circumstances, living with foreign capital seemingly entails almost the same recession risks as making a determined effort to live without it. ■

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 2/21/90	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	222.665	+ 1.245	- 9.257
Loans to Depository Inst.	1.888	+ .816	+ .155
Float	1.567	+ .950	+ .352
Total Reserve Bank Credit	264.137	+ .729	+10.741
Treasury Deposits with Federal Reserve Banks	4.783	- 1.663	- .292
Currency in Circulation	255.230	+ .566	+14.445
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	225.040	- 2.546	- 5.730
	2/21/90		
Member Bank Reserves:			
Total Reserves Held	59.061	- .253	+ .060
Excess (Deficiency)	.992	- .218	- .024
Net Borrowed Reserves	.355	+ .733	+ 1.005
Monetary Aggregates †		**‡ % Change Since 3 Months Ago***	**% Change Since Year Ago**
M1 (2/12/90)	798.6	+ 4.5	+ 1.3
M2 (2/12/90)	3,252.2	+ 7.8	+ 5.8
M3 (2/12/90)	4,068.9	+ 4.3	+ 3.6
Domestic Nonfinancial Debt (3rd Q'89)	9,604.5	+ 7.5	+ 8.2

† Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 2/23/90	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	7.70%	7.71%	7.56%
* Federal Agencies	7.80	8.00	8.10
* Municipal Notes–High Grade (34% Taxable Equivalent)	8.33	8.48	8.48
Negotiable Time CDs			
Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	8.30	8.30	8.35

‡ Finance Company Paper–Prime

5- 14 days	8.10%
15- 29 days	8.10
30- 59 days	8.10
60- 89 days	8.05
90-179 days	7.50
180-239 days	7.25
240-270 days	7.25

‡* Bankers' Acceptances

Mar.	8.15%
Apr.	8.11
May	8.07
Jun.	8.03
Jul.	8.00
Aug.	7.96

‡ Industrial Paper–Prime

30- 89 days	8.20%
90-120 days	8.14

†Federal Funds Effective Rate 8.25%

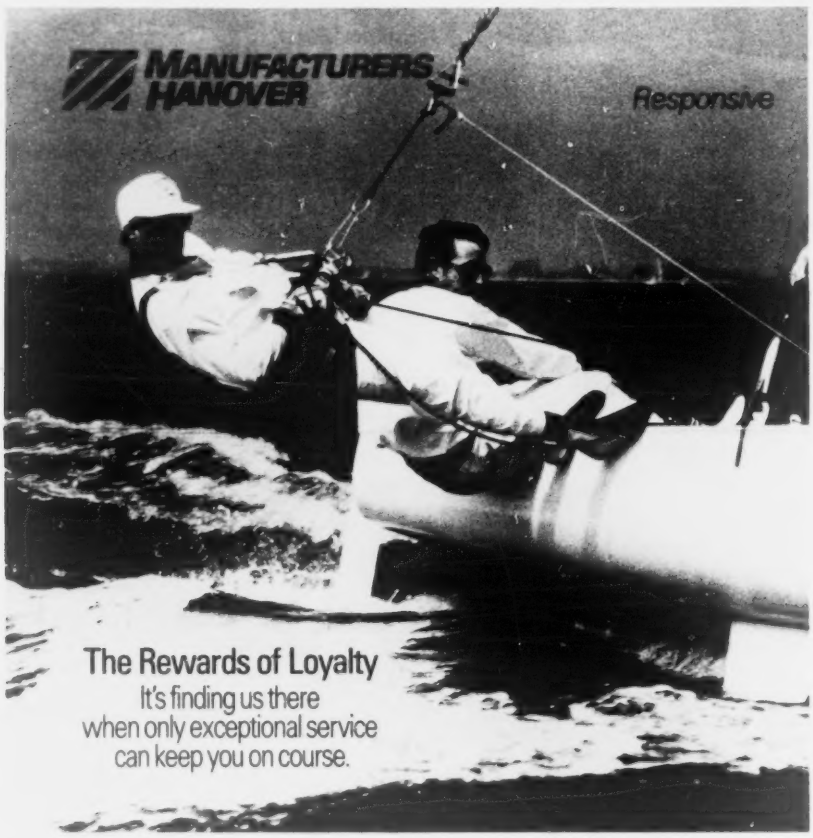
‡ Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	4th Q'89	$ 5,337	$ 5,281	$ 5,017
Gross National Product (1982 Dollars)*	4th Q'89	$ 4,168	$ 4,163	$ 4,069
Percent Change, Annual Rate	4th Q'89	0.5	3.0	2.7
Change in Consumer Prices*	Jan '90n	13.2%	4.8%	7.2%
Change in MH Cost of Living Index*	Jan '90n	13.2%	3.6%	8.4%
Change in Producer Prices*	Jan '90	21.6%	7.2%	13.2%
Civilian Employment (Thousands of Persons) †	Jan '90	117,863	117,888	116,640
Unemployment as % of Civilian Labor Force †	Jan '90	5.3%	5.3%	5.4%
Personal Income*	Dec '89	$ 4,569	$ 4,548	$ 4,206
Leading Indicators Composite Index (1967=100) †	Dec '89	145.7	144.6	145.1
Industrial Production Index (1977=100) †	Jan '90n	140.9	142.5r	140.8
Net Change in Consumer Installment Credit †	Dec '89	$ 4.91	$ 4.60	$ 5.09
U.S. Merchandise Trade Balance †	Dec '89n	-$ 7.17	-$ 10.29r	-$ 10.80
Plant and Equipment Expenditures*	1st Q'90	$ 503.5(a)	$ 485.5(a)	$ 459.5
Private Housing Starts (Thousands of Units)*	Jan '90n	1,625	1,254r	1,659r
New Construction Expenditures*	Dec '89	$ 414.6	$ 417.3	$ 425.0
Total Business Inventories †	Dec '89n	$ 795.2	$ 797.0r	$ 753.3r
Total Business Sales †	Dec '89n	$ 522.5	$ 522.3r	$ 507.1r

*Seasonally adjusted annual rate. † Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.



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MANUFACTURERS HANOVER

Financial Digest

Volume XXVII, Number 6 Monday, March 12, 1990

Analysis of Business Trends Plus Selected Financial Indicators

Interest Rates Rise Globally

Political developments in Eastern Europe are dominating the global financial markets this year. However, the initial euphoria about the positive effects that they would have on economic growth in the industrial countries, especially West Germany, has been largely replaced by concerns over the hefty burden that they could place on West Germany's economic and financial resources. Fears that monetary union between East and West Germany and an eventual rescue of the East German economy will result in greater government spending, higher borrowing needs and a loftier inflation rate in West Germany have pushed up German interest rates substantially in recent weeks. In particular, worries that the unification of the Deutschemark and East German mark may be implemented at an inflationary one-for-one exchange rate have caused the West German 10-year bond yield to soar to nine percent, its highest level since the early 1980s.

While one could expect that rising interest rates in West Germany would produce higher rates throughout Western Europe, given the strong link between the Deutschemark and the European currencies via the European Monetary System (EMS), the integration of financial markets worldwide is one of the reasons why interest rates have gone up in Japan and the United States as well.

Although Japan's strong economic growth, surging money supply, tight labor market and weakening currency may justify higher Japanese interest rates, this is certainly not the case in the United States. Indeed, with the dollar appreciating, inflation more or less under control and signs of a marked slowdown in the pace of business activity increasing, a case could even be made for lower interest rates in this country (Financial Digest—February 26, 1990).

Germany Sets The Direction

However, West Germany is setting the direction, if not the pace, of interest rate movements around the world. Thus it has become increasingly important for monetary authorities, economists, business leaders and investors in all countries to be aware not only of the rapid economic and political changes that are taking place there today, but also of their implications for Germany's inflation outlook and the Bundesbank's monetary policy.

Before the sharp deterioration of the East German economy and the flood of East German immigrants into West Germany accelerated the move toward German economic and monetary union, the Bundesbank's chief inflation concerns were focused on rising wage demands, especially from West Germany's largest union, IG Metall. However, any hefty wage settlements, as well as a looser fiscal policy resulting from planned tax cuts and the influx of East German immigrants, were expected to prompt the central bank to maintain a tight rein on monetary policy, thereby keeping the inflation rate in the three percent neighborhood this year. Indeed, reflecting the Bundesbank's tight grip, consumer prices rose by only 2.6 percent in February (year-over-year), while wholesale prices increased by a mere 1.4 percent in January. Import prices actually declined in January due to the strength of the Deutschemark.

With inflation well under control, the major forces driving up West German interest rates would appear to be market concerns that the rapid deterioration of the East German economy and the flood of East German immigrants into West Germany may cause political factors to override economic considerations. This means that the West German government might throw caution to the wind in its dealings with East Germany, especially with regard to a monetary union. Investors are particularly concerned that an overgenerous exchange rate, while protecting East German savings, would fuel West German inflation. They are also worried that huge increases in government spending to accommodate East German immigrants and rebuild the East German economy will add to inflation pressures.

Yet, it just may be political factors that will cause West German Chancellor Helmut Kohl to err on the side of caution. This is because he himself faces an election this December, and regardless of the stage of German unification by then, the bulk, if not all of the voters who will decide its outcome will be the inflation-conscious West Germans. It is not likely that

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Mr. Kohl has forgotten that a major factor that cost his predecessor, Helmut Schmidt, his job back in 1982, was a surge in Germany's inflation rate as Mr. Schmidt succumbed to international pressures to reflate the German economy in order to help pull Europe out of recession.

What is more, it appears that the warm welcome given to East German immigrants last November is being quickly replaced by feelings of resentment as the West Germans have begun to realize that liberal handouts to their brothers spell fewer social benefits and higher taxes for them. Thus, despite remarks by Chancellor Kohl that he sympathizes with an exchange rate that would preserve the value of East German savings, it is West German concerns that he must ultimately address, especially in an election year.

Money Will Stay Tight

Finally, the Bundesbank's long-standing commitment to price stability will probably prevent a sharp rise in West Germany's inflation rate. While the ultimate decisions regarding monetary and economic union belong to Bonn, it is doubtful that Chancellor Kohl

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (2/21/90)	216,761	- 682	+ 7,497
New York City (2/28/90)	41,035	- 322	- 1,150
Commercial Paper (2/28/90)	540,197	+ 2,174	+ 52,790

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loan

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (2/21/90)	320,796	+ 433	+ 11,158
New York City (2/28/90)	59,653	+ 522	+ 2,081

Total Loans and Leases Gross Adj

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (2/21/90)	1,007,189	+ 618	+ 65,056
New York City (2/28/90)	181,919	- 2,090	- 1,164

Financial Markets

	Friday 3/9/90	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	8.25%	+ .25	- .79
180-Day Bills†	8.31	+ .16	- .98
Longest Bills†	8.44	+ .26	- 1.11
Recent Issues:			
8½s 2/28/92	8.71	+ .25	
7⅞s 12/31/93	8.75	+ .22	
8½s 2/15/00	8.65	+ .22	
8½s 2/15/20	8.63	+ .08	
Municipals:			
Bond Buyer—20 Bond Index* (3/8/90)	7.25%	–0–	- .27
Blue List Total ($ Million)	$1,445	- $ 148	+ $179
30-Day Visible Supply ($ Million)	$2,432	+ $1,082	+ $258
Total	$3,877	+ $ 934	+ $437
Corporates:			
Moody's Aa Composite (3/8/90)	9.47	- .02	- .44
30-Day Visible Supply ($ Million)	$1,450	- $ 600	- $557
Stocks:			
Dow-Jones Averages:			
Industrials	2,683.33	+ 22.97	+401.19
Transportation	1,139.05	- 6.93	+ 74.85
Utilities	219.50	- .13	+ 37.13
65 Stocks	999.40	+ 2.79	+128.63
N.Y.S.E. Composite Index	186.18	+ 1.21	+ 21.33
N.Y.S.E. Avg. Daily Vol. for Week (000's)	154,266	- 8,162	- 3,899

*34% Taxable equivalent 10.98%

† Bond equivalent

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 3/9/90	Week Ago
Overnight	8.19%	8.13%
1 month	8.25	8.25
3 month	8.50	8.31
6 month	8.50	8.38
1 year	8.81	8.63

FOREIGN EXCHANGE SPOT RATES

New York Opening (3/9/90)	Currency Per U.S. $	Week Ago
Belgium	35.35	35.74
Canada	1.1781	1.1935
France	5.7560	5.7975
Germany	1.7010	1.7210
Italy	1256.50	1268.70
Japan	151.30	149.65
Mexico	2717.00	2710.00
Netherlands	1.9155	1.9340
South Korea	698.10	693.00
Switzerland	1.5070	1.5092
Taiwan	26.40	26.15
U.K.*	1.6205	1.6555

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (3/9/90) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/
	+0.2%	-1.2

would implement any agreements without the approval of the Bundesbank, given the central bank's high esteem in West Germany—not to mention elsewhere.

So while the effects of currency union and additional fiscal spending may nudge this year's inflation rate a little higher than initially expected, an explosion in prices is highly unlikely. Indeed, hefty wage increases, the Bundesbank's major inflation concern before talk of monetary union, will probably be held in check by the flood of immigrants from East Germany.

While a jump in West Germany's inflation rate is highly unlikely, uncertainty over the terms and effects of monetary union will continue to place upward pressure on German interest rates in the coming months. At the same time, the need for the Bundesbank to maintain its credibility will keep German monetary policy tight. The central bank will probably lift its discount rate another 50 basis points from its current six percent, although it will likely wait until the terms of monetary union are set sometime after the East German elections on March 18 in order to assess their effects on West German inflation.

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 3/7/90	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	227.669	+ 3.333	- 7.789
Loans to Depository Inst.	2.059	+ .185	- .034
Float	.471	- .433	- .999
Total Reserve Bank Credit	268.681	+ 3.222	+10,685
Treasury Deposits with Federal Reserve Banks	6.193	+ .060	+ 1.018
Currency in Circulation	255.617	_ .651	+14.391
Gov'ts held for Foreign Acct by F.R. Banks (End-of-Week)	223.812	- .539	- 9.337
Member Bank Reserves:	**3/7/90**		
Total Reserves Held	59.086	- .056	+ .119
Excess (Deficiency)	.816	- .175	- .141
Net Free Reserves	.690	+ 1.046	+ .283
Monetary Aggregates †		**‡ % Change Since 3 Months Ago***	**Year Ago**
M1 (2/26/90)	804.9	+ 5.9	+ 1.7
M2 (2/26/90)	3,264.8	+ 7.3	+ 6.1
M3 (2/26/90)	4,072.9	+ 4.0	+ 3.6
Domestic Nonfinancial Debt (3rd Q'89)	9,604.5	+ 7.5	+ 8.2

† Seasonally adjusted. * Seasonally adjusted annual rate. ‡ Four-week moving average.

New York Money Market

Offering Rates 3/9/90	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	7.96%	7.88%	7.83%
* Federal Agencies	8.13	8.30	8.35
* Municipal Notes–High Grade (34% Taxable Equivalent)	8.33	8.53	8.71
Negotiable Time CDs Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	8.35	8.45	8.60

‡ Finance Company Paper–Prime

5- 14 days	8.23%
15- 29 days	8.23
30- 59 days	8.20
60- 89 days	8.15
90-179 days	7.88
180-239 days	7.50
240-270 days	7.50

‡ Industrial Paper–Prime

30- 89 days	8.25%
90-120 days	8.23

‡* Bankers' Acceptances

Apr	8.23%
May	8.20
Jun.	8.18
Jul.	8.15
Aug	8.14
Sep.	8.13

†Federal Funds Effective Rate 8.31%

‡ Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	4th Q'89	$ 5,338 r	$ 5,281	$ 5,017
Gross National Product (1982 Dollars)*	4th Q'89	$ 4,172 r	$ 4,163	$ 4,069
Percent Change, Annual Rate	4th Q'89	0.9 r	3.0	2.7
Change in Consumer Prices*	Jan '90	13.2%	4.8%	7.2%
Change in MH Cost of Living Index*	Jan '90	13.2%	3.6%	8.4%
Change in Producer Prices*	Jan '90	21.6%	7.2%	13.2%
Civilian Employment (Thousands of Persons) †	Feb '90n	118,035	117,863	116,757
Unemployment as % of Civilian Labor Force †	Feb '90n	5.3%	5.3%	5.2%
Personal Income*	Jan '90n	$ 4,603	$ 4,567r	$ 4,273
Leading Indicators Composite Index (1967=100) †	Jan '90n	145.3	145.3r	146.0
Industrial Production Index (1977=100) †	Jan '90	140.9	142.5	140.8
Net Change in Consumer Installment Credit †	Jan '90n	$ 3.54	$ 4.35r	$ 22.52
U.S. Merchandise Trade Balance †	Dec '89	- $ 7.17	- $ 10.29	- $ 10.80
Plant and Equipment Expenditures*	1st Q'90	$ 503.5(a)	$ 485.5(a)	$ 459.5
Private Housing Starts (Thousands of Units)*	Jan '90	1,625	1,254	1,659
New Construction Expenditures*	Jan '90n	$ 424.0	$ 416.6r	$ 423.0
Total Business Inventories †	Dec '89	$ 795.2	$ 797.0	$ 753.3
Total Business Sales †	Dec '89	$ 522.5	$ 522.3	$ 507.1

*Seasonally adjusted annual rate. † Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

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Financial Digest

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Analysis of Business Trends Plus Selected Financial Indicators

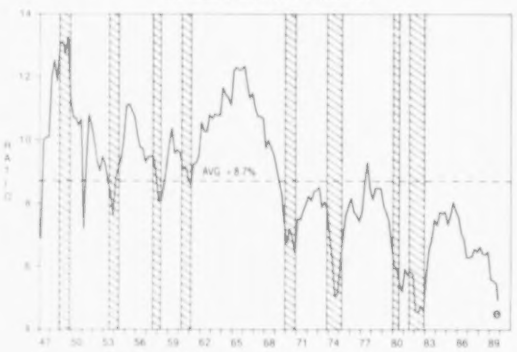
Corporate Profits In A Tailspin

While the mercurial consensus of economic opinion seems to have abandoned the idea that recession is imminent, and some of the more predictable pundits are again warning of the dangers of a quickening pace of business and galloping inflation, it would be hard to tell that the economy was reawakening, judging from the depressed condition of corporate profits. With corporate America's ability to raise selling prices severely limited by strong consumer resistance to price increases, unit labor costs trending higher and interest expense ballooning, a good chunk of industry, ranging from high-technology firms, to retailers, to defense contractors, finds itself in the throes of a significant earnings squeeze. Although vigorous efforts are underway to rein in costs, at this juncture the results have been mixed. Thus, the profits pinch remains one of the greatest threats to today's economic expansion, jeopardizing employment, inventory and capital spending levels.

Although the Commerce Department has yet to officially report fourth quarter 1989 profits, with business activity faltering and costs rising, it appears that the news was hardly good. According to estimates by this Bank, before-tax book profits ran at a $265 billion annual rate in the fourth quarter. This is down $10 billion from quarter-earlier levels, and off by nearly $55 billion, or 17 percent, compared with same-quarter 1988 levels. This marked the third straight quarter in which before-tax profits fell short of year-earlier levels, something which hasn't happened since the manufacturing slump of 1986. After-tax profits fared little better, tumbling by more than $6 billion in the fourth quarter compared with third-quarter levels, to an annual rate of $146 billion—the weakest earnings performance in 2½ years.

The tailspin in book profits reveals only part of the deterioration of corporate profitability. Profits from current production, or operating profits, which net out of reported earnings the impact of inflation-fueled inventory profits and adjust for swings in depreciation allowances, continue to tumble at an even faster clip than book earnings. Before- and after-tax operating earnings have dropped for four quarters in a row. The crumbling of after-tax operating earnings has been especially pronounced. They now stand nearly 20 percent below their fourth quarter 1988 peak, and are back to where they were in late 1983. As shown in the chart, operating profit margins have plunged, and are at levels usually experienced only during recessions.

RATIO OF CORPORATE AFTER-TAX OPERATING PROFITS TO CORPORATE PRODUCT



Source: Commerce Department

Cost-Cutting To The Fore

Unfortunately, reversing the earnings slide will not be easy. With the potential for meaningful revenue gains through either increased sales or price hikes limited by today's subdued economic growth and a relatively becalmed inflation environment, cost-cutting is believed to be the most effective avenue for breathing new life into the bottom line. But, despite modest inflation, cost pressures continue to build, reflecting the upward creep of wages and mandated benefit costs, and the highly-leveraged nature of corporate America.

Most cost-cutting measures have so far zeroed in on labor costs. Although average hourly earnings growth has been lethargic, advancing by less than four percent during the 12-months ending in February, even this modest rise has been quicker than either the pace at which most firms have been able to raise selling prices or, more important, productivity growth. As a result, unit labor costs are under steady upward pressure. They are now rising at a better than five percent clip—the fastest rate of rise since the 1981-82 recession.

Manufacturers Hanover Economics Department 17/270

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But direct wage costs are only part of the labor cost package. Equally important has been the surge in benefit costs. These range from mandated hikes in the employer tax rate for Social Security contributions, to exploding medical insurance costs, to employer reimbursement of educational expenses. Wage and benefit costs together are advancing at a much brisker clip than wages alone, widening the gap between productivity and compensation even further. Not surprisingly, white- and blue-collar layoffs alike have mounted, widespread in manufacturing at first, but now extending to labor-intensive service industries such as commercial banking and brokerage firms.

With large chunks of corporate America suffering under the weight of hefty debt burdens, profits restoration must go beyond trimming labor costs. At some point, it must include shoring up the balance sheet. This is because since the end of the 1970s, total credit market debt owed by nonfinancial corporate business has swollen from just $775 billion to better than $2 trillion currently, an average annual rate of growth in excess of 10½ percent. Interest payments grew apace, and were running at a record $154 billion annual rate in the fourth quarter of last year. This was up 15 percent compared with the same quarter of 1988. With profits and cash

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (3/7/90)	219,380	+ 4,050	+ 5,265
New York City (3/14/90)	40,821	- 3,484	- 2,502
Commercial Paper (3/14/90)	542,071	+ 1,116	+ 54,758

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (3/7/90)	324,374	+ 1,064	+ 13,471
New York City (3/14/90)	59,541	- 264	+ 1,972

Total Loans and Leases Gross Adjus

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (3/7/90)	1,008,044	+ 1,210	+ 66,195
New York City (3/14/90)	181,129	- 1,579	+ 1,402

Financial Markets

	Friday 3/23/90	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	8.13%	- .02	- 1.24
180-Day Bills†	8.24	- .01	- 1.32
Longest Bills†	8.27	- .05	- 1.41
Recent Issues:			
8⅛s 2/28/92	8.55	- .05	
7⅞s 12/31/93	8.60	- .03	
8⅛s 2/15/00	8.51	- .05	
8⅛s 2/15/20	8.47	- .06	
Municipals:			
Bond Buyer—20 Bond Index* (3/22/90)	7.31%	- .01	- .41
Blue List Total ($ Million)	$1,612	+ $ 33	+$ 283
30-Day Visible Supply ($ Million)	$2,500	+ $1,197	+$1,214
Total	$4,112	+ $1,230	+$1,497
Corporates:			
Moody's Aa Composite (3/22/90)	9.50	- .07	- .52
30-Day Visible Supply ($ Million)	$2,394	+ $1,110	- $ 265
Stocks:			
Dow-Jones Averages:			
Industrials	2,704.28	- 36.92	+461.24
Transportation	1,170.87	+ 14.04	+162.78
Utilities	213.72	- 3.77	+ 31.58
65 Stocks	1,007.65	- 6.65	+159.00
N.Y.S.E. Composite Index	185.45	- 2.47	+ 22.81
N.Y.S.E. Avg. Daily Vol. for Week (000's)	145,833	- 11,715	- 2,504

*34% Taxable equivalent 11.08%

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 3/23/90	Week Ago
Overnight	8.13%	8.19%
1 month	8.31	8.31
3 month	8.38	8.44
6 month	8.50	8.56
1 year	8.75	8.88

FOREIGN EXCHANGE SPOT RATES

New York Opening (3/23/90)	Currency Per U.S. $	Week Ago
Belgium	35.41	35.30
Canada	1.1760	1.1830
France	5.7450	5.7415
Germany	1.7060	1.6950
Italy	1256.00	1251.00
Japan	154.45	152.20
Mexico	2731.00	2724.00
Netherlands	1.9210	1.9135
South Korea	698.20	697.20
Switzerland	1.5080	1.5100
Taiwan	26.40	26.50
U.K.*	1.6045	1.6242

*U.S. $ per U.K. pound

MH TRADE-WEIGHTED DOLLAR (3/9/90) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	+0.4%	-0.4%

flow squeezed, rising interest payments are now absorbing a huge 44 percent of net cash flow, up from 33 percent two years ago.

Dividends Could Be A Casualty

Jobs and capital spending are two of the more obvious casualties of dwindling profitability. The next may be the shareholder. For notwithstanding the plunge in earnings, shareholders have so far escaped generally unscathed. Dividend payments have doubled in the past seven years, and continue to run at record levels. They advanced another nine percent during the four quarters ending last December, to an annual rate of $126 billion. But, with 86 percent of after-tax earnings currently being distributed to shareholders, prospects for additional dividend gains are slim to none.

In fact, unless profits rebound quickly, quite the opposite will occur. Many firms have already bit the bullet, as the number of dividend cuts and omissions in 1989 was 27 percent higher than in 1988. While only a short-term palliative, widespread dividend cuts might become necessary if even more extensive reductions in capital spending and employment are to be avoided.

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 3/21/90	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	225.977	+ .254	- 9.468
Loans to Depository Inst.	2.226	+ .095	+ .807
Float	.586	- .177	- .140
Total Reserve Bank Credit	268.696	+ .249	+11.581
Treasury Deposits with Federal Reserve Banks	5.001	+ .073	+ .781
Currency in Circulation	257.120	+ .186	+14.865
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	220.507	- 1.301	- 12.641
	3/21/90		
Member Bank Reserves:			
Total Reserves Held	59.439	+ .374	+ .725
Excess (Deficiency)	.832	+ .036	+ .097
Net Free Reserves	.649	- .021	+ .336
Monetary Aggregates †		**‡ % Change Since 3 Months Ago***	**Year Ago**
M1 (3/12/90)	802.2	+ 6.5	+ 1.9
M2 (3/12/90)	3,269.3	+ 7.0	+ 6.1
M3 (3/12/90)	4,069.4	+ 3.5	+ 3.3
Domestic Nonfinancial Debt (4th Q'89)	9,790.0	+ 2.1	+ 8.1

† Seasonally adjusted

* Seasonally adjusted annual rate
‡ Four-week moving average

New York Money Market

Offering Rates 3/23/90	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	7.90%	7.84%	7.73%
* Federal Agencies	8.12	8.30	8.35
* Municipal Notes–High Grade (34% Taxable Equivalent)	8.94	9.09	9.24
Negotiable Time CDs			
Manufacturers Hanover	Rates By Arrangement		
* Secondary Market–Prime	8.36	8.53	8.60

‡ Finance Company Paper–Prime

5- 14 days	8.23%
15- 29 days	8.23
30- 59 days	8.20
60- 89 days	8.15
90-179 days	7.88
180-239 days	7.50
240-270 days	7.50

‡* Bankers' Acceptances

Apr.	8.27%
May	8.23
Jun.	8.20
Jul.	8.18
Aug.	8.19
Sep.	8.17

‡ Industrial Paper–Prime

30- 89 days	8.32%
90-120 days	8.29

†Federal Funds Effective Rate 8.25%

‡ Discount basis *Subject to availability † Estimated

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross National Product (Current Dollars)*	4th Q'89	$ 5,338	$ 5,281	$ 5,017
Gross National Product (1982 Dollars)*	4th Q'89	$ 4,172	$ 4,163	$ 4,069
Percent Change, Annual Rate	4th Q'89	0.9	3.0	2.7
Change in Consumer Prices*	Feb '90n	6.0%	13.2%	4.8%
Change in MH Cost of Living Index*	Feb '90n	12.0%	13.2%	6.0%
Change in Producer Prices*	Feb '90n	0.0%	21.6%	7.2%
Civilian Employment (Thousands of Persons) †	Feb '90	118,035	117,863	116,757
Unemployment as % of Civilian Labor Force †	Feb '90	5.3%	5.3%	5.2%
Personal Income*	Jan '90	$ 4,603	$ 4,567	$ 4,273
Leading Indicators Composite Index (1967=100) †	Jan '90	145.3	145.3	146.0
Industrial Production Index (1977=100) †	Feb '90n	141.8	141.0r	140.5
Net Change in Consumer Installment Credit †	Jan '90	$ 3.54	$ 4.35	$ 22.52
U.S. Merchandise Trade Balance †	Jan '90n	- $ 9.25	- $ 7.68r	- $ 8.52r
Plant and Equipment Expenditures*	1st Q'90	$ 503.5(a)	$ 485.5(a)	$ 459.5
Private Housing Starts (Thousands of Units)*	Feb '90n	1,477	1,588r	1,454
New Construction Expenditures*	Jan '90	$ 424.0	$ 416.6	$ 423.0
Total Business Inventories †	Jan '90n	$ 796.0	$ 794.1r	$ 760.2r
Total Business Sales †	Jan '90n	$ 523.0	$ 521.3r	$ 511.5r

*Seasonally adjusted annual rate † Seasonally adjusted n-Newly reported figure r-Revised a-Anticipated